IRON ORE & STEEL FORUM
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CAPITALISING ON AUSTRALIA'S NATURAL ADVANTAGES IN STEELMAKING
SPEECH – LANCE HOCKRIDGE

INTRODUCTION

Ladies and gentlemen, it's a pleasure to speak to you this morning at this important industry forum.

This morning I'd like to paint a picture for you about the strength of the Australian steel industry and in particular the strength of the new BHP Steel.

I'd also like to talk about some things BHP Steel believes ought to be done to reinforce that strength.

And I'd like to mention some things that potentially threaten that strength.

In particular, I will cover four main topics:

- the continuing difficult state of the global steel industry, overcapacity, and capacity reduction measures;
- maximising the cost, efficiency and technology advantages we enjoy in Australia;
- demand for steel and steel pricing trends; and
- the importance of initiatives to overcome trade restrictions, including potential advantages for our industry from free trade agreements, such as the one proposed between Australia and the USA.

BHP STEEL INDUSTRIAL MARKETS

As was mentioned in the introduction, my position at BHP Steel is President Industrial Markets.

In this role I have responsibility for three modern and world-class manufacturing operations:

- The Port Kembla Steelworks, which produces over 5 million tonnes of flat steel products each year;
- New Zealand Steel, located at Glenbrook just outside Auckland, which produces 620,000 tonnes per year; and
- North Star BHP Steel, a 1.6 million tonne per year steel producer located in Ohio, in the USA, in which we have a 50 per cent interest.

North Star was recently rated the number one steel company in North America for overall customer service in the prestigious Jacobsen survey, ahead of industry leaders such as Dofasco and Nucor.

My team of people is therefore responsible for customers who purchase over 7.4 million tonnes of steel each year – about 2 million tonnes of this is sold to BHP Steel's own downstream Australian Building and Manufacturing Markets business, and we compete successfully with the world's best steel companies in placing over 5 million of these tonnes.

We have a well-earned reputation for quality, customer service, technology and product innovation. And these are the elements on which we will continue to build our future.

Another exciting part of my business is stewardship of BHP Steel's investment in Castrip. This BHP Steel-developed thin strip casting technology is in the process of being commercialised at our partner Nucor's purpose-built plant in Crawfordsville, Indiana.

BHP Steel is the major Australian steel exporter. In FY 2002, for example, we exported over 40 per cent of our total production by tonnage.

And as the major Australian steel exporter we have a unique insight into global steel markets, customers and trade relationships.

The creation of BHP Steel as a separately listed company from July this year has provided investors with the opportunity to invest directly in the largest steel company in Australia and New Zealand.

There is no doubt today that BHP Steel is a different kind of steel company – different to the business it was as part of the old BHP and different to its peer companies in the international steel industry.

THE STATE OF THE GLOBAL STEEL INDUSTRY AND INDUSTRY OVERCAPACITY

The global steel industry continues to face significant structural issues, which impede its attractiveness to investors.

It faces massive overcapacity - recent estimates put it at well over 150 million tonnes per year.

Overcapacity is a particular feature of the steel industries of Eastern Europe and the former Soviet Union, Asian and the European Union.

Elsewhere – such as the United States – there are major issues to do with efficiency of sectors of the steel industry, particularly where governments have been prepared to introduce non-competitive support measures for their industries.

In this environment, there is little room for new steel making capacity other than in places where there is enormous growth in consumption, such as China.

In the 20^{th} century, every country felt it needed a steel industry, just like it needed an airline industry.

Just as we are seeing a shakeout in the global aviation industry, so too we are now facing the globalisation of the steel industry.

The world of the 21^{st} century is a world of major customers, pricing transparency – especially aided by instant electronic communications – efficient transportation systems, and known, highly competitive sources of raw materials.

The general transparency of the industry will serve to drive much greater efficiencies.

In this environment, what is essential is low cost operations.

BHP Steel's credentials in this new world is as one of the handful of lowest cost hot rolled coil producers in the world.

By contrast, the US integrated producers – those whose troubles have been in the headlines over the past year – are almost all in the highest quartile of the cost curve.

In addition to overcapacity, the global steel industry is highly fragmented.

While there has been some consolidation, it is nothing like what we have seen in kindred metals industries, such as aluminium.

At the close of 2001, the top five steel companies accounted for less than 20 per cent of the world steel market.

By comparison, the top five aluminium producers accounted for almost 50 per cent of the world market.

And the top three iron ore producers in the world account for 70 per cent of the ship-borne supply.

The fragmentation of our industry leads to steel companies having comparatively high levels of capital intensity and impedes competitiveness.

It also makes production lines difficult to shut down in market downturns.

Amongst many steel companies, a commodity mentality prevails, especially in international markets where commodity trading is apparent.

Moreover, the global steel industry has been spectacularly successful in destroying shareholder value.

Return on capital worldwide has generally been poor, with the median total shareholder return for companies in the steel sector worldwide over the past decade being less than zero.

It is this performance as an industry which has investors and bankers right around the world shying away from contributing additional capital to anyone other than the very best steel companies with proven track records.

The litany of Chapter 11 bankruptcies in the US represents a string of disasters for investors.

The days of capital being freely available for good new technology ideas are long gone. The industry is entering a period where it needs to consolidate its performance and re-establish its reputation as a desirable destination for investment capital.

Internationally, the improved profitability of steel companies in recent months has largely come on the back of tariffs and other market-distorting government intervention, and short-term capacity closure – although much of this capacity is now reopening in light of higher prices.

In fact, I would argue that Chapter 11 itself is a hidden subsidy, allowing as it does companies to escape from their debts and re-enter the market with a lower cost of capital than when they entered bankruptcy protection.

By contrast, today's Australian steel industry is relatively prosperous.

With the public listing of BHP Steel we now have a steel sector within the Australian Stock Exchange which features three dynamic listed steel companies. We, along with our customers OneSteel and Smorgon Steel, have worked hard in recent years to restructure, reduce costs and improve profitability.

Unlike much of the rest of the world, Australia has succeeded in significantly reducing much of the overcapacity which previously existed in this country.

In Australia, the market for flat products currently stands at some 2.9 million tonnes, of which 80% - or 2.4 million tonnes – is supplied by BHP Steel.

The remaining 20 per cent comprises imports.

We therefore rely to a significant extent on export markets for the prosperity of our industry.

The steel industry in Australia is relatively small and mature by world standards.

However, it still offers significant opportunities for product and market growth.

BHP Steel's Port Kembla Steelworks produces over 5 million tonnes per year, providing scale economies that mean we are cost competitive with the rest of the world.

In the last financial year we exported about 44% of our production by tonnage, predominantly to a long-term stable customer base.

Thinking about Australia's efforts to restructure its steel industry, I speak to you as the leader of the team at BHP Steel that had the difficult task in 1999 of closing the Newcastle Steelworks.

The closure of Newcastle reduced Australian raw steel making capacity by 1.76 million tonnes to about 7.4 million tonnes.

One of the major reasons Newcastle had to close was that Australian steel production at the time was too high, relative to the size of the domestic market.

Newcastle also suffered from its out-of-date plant and equipment technology and lack of scale compared to the most competitive steel works of the world (including Port Kembla).

The decision to close the inefficient capacity at the Newcastle Steelworks was critical and has contributed to the very healthy state of the industry in Australia today.

But I certainly wouldn't want to live through the closure of another steelworks and I wouldn't recommend it to anyone in this room today.

If that decision had not been taken, there is no doubt in my mind that the Australian steel industry would not have navigated the turbulent waters of the past two years – with 20 year lows in international steel prices – as well as it has.

Indeed, my assessment is that circumstances in the Australian industry could have been compounded by a failure to obtain exclusions from s.201, as we did earlier this year.

A decisive factor in our lobbying effort in the US was our ability to point to the restructuring the Australian industry has undergone – and in particular the closure of steelmaking at Newcastle.

It is very clear, therefore, that the Australian steel industry today is finely balanced.

There is quite some scope for incremental increases in capacity from existing operations, but opening large-scale new steel making capacity in this environment would do nothing to increase the overall prosperity of the Australian steel industry or Australia in general.

Speaking of incremental increases in capacity, in Australia we are hatching plans to further expand our metal coating and painting operations within the next 6-24 months.

The expansion of existing facilities can be accomplished at much less capital cost than the cost of a new greenfield site and will further improve our already low costs of coated and painted product.

You can expect to see a plethora of new products, new colours, and advanced finishes from BHP Steel in coming months and years.

We see clear evidence of the growth that is available in the Australian domestic market, including through success in inter-material competition and in developing new applications for steel.

Already, at Port Kembla, we have for the last five months been producing at an increased average weekly rate of about 100,000 tonnes.

And we continue to do everything available to us to get even more efficient tonnes out of our Port Kembla facility.

Of course we can’t stop new entrants – it’s an open market.

But we will compete aggressively to maintain and grow our market share. And I know all of the existing players in the domestic market will be vigorous competitors.

Fortunately the market is rational and well informed. The market knows how finely balanced steel is and knows how existing players would respond to new competitive threats.

Given the exciting opportunities available to existing players in Australia, we would argue it simply doesn’t make sense to open new steel making capacity in Australia so soon after the closure of Newcastle – especially when that existing capacity is demonstrably world-class.

If steel companies fail financially, that is not healthy for anyone. At the very least, there would be significant adverse impacts on regional economies, to say nothing of the national consequences.

In such a finely balanced industry, it is essential that governments do not do anything to distort the market or upset its equilibrium.

CAPACITY REDUCTION MEASURES

For over 12 months now, Australia has been participating in an inter-governmental effort – coordinated by the OECD – to reduced excess steel making capacity.

At the most recent OECD meeting on this subject, there was strong industry support for a governmental initiative to discipline subsidies and related government support.

There is broad consensus that most subsidies and related government support should be banned, except for the purposes of facilitating permanent plant closures, the environmental cleanup associated with such closures, and social assistance for displaced workers.

In addition to a prohibition on subsidies, a number of governments and the industry have called for a ban on the use of export credits for steel, and a stop to development bank financing for new plants.

The implementation of this proposal will, of course, require the active commitment of governments around the world, including in Australia.

This approach has been agreed by the International Iron & Steel Institute (IISI) who, nevertheless, have made the point that progress to date has been painfully slow.

In fact, mothballed production capacity has come back on stream as producers seek to take advantage of current higher steel prices.

Subsidies will simply have the effect of postponing the necessary changes to our industry.

Already we've seen this in the US. Those producers who argued the loudest for the shelter of tariffs to give them time to get their house in order, have shown no signs whatsoever of restructuring their businesses.

And over-reliance on international markets makes you a price taker, not a price maker.

So let's make sure the Australian steel industry remains part of the solution to the woes of the global steel industry, and doesn't become part of the problem.

THE REGIONAL IMPORTANCE OF THE STEEL INDUSTRY

The Australian steel industry makes a strong and vital contribution to major regional economies around the country.

Port Kembla Steelworks and BHP Steel's other downstream activities at Port Kembla remain mainstays of the Illawarra regional economy – we create direct employment for 6,000 people in the region, and indirect employment for thousands more.

We also put about $1.25 billion into the economy, in the form of wages and spending on goods and services.

In Victoria, our Western Port Works is the largest employer in the Mornington Peninsula region, employing some 1,300 people.

OneSteel is the major contributor to the economy of Whyalla, the second largest city in South Australia, and each of the major steel companies have significant steel distribution activities around a wide range of important regional centres.

Despite the cessation of steel making in 1999, steel continues to be an important feature of the now very diverse Hunter Valley regional economy. OneSteel and Smorgon both have major operations in Newcastle and together employ about 1,500 people.

I would like to say how impressed I've been with the diversification and transformation of the Hunter economy in the five years since BHP announced in 1997 that the Steelworks would be closed.

Newcastle has truly moved on, and no longer needs to make steel as a centrepiece of its identity. Rugby League grand final wins and export successes in downstream value-added industries, together with a vibrant tourism industry, ensure this.

The regional importance of the steel industry is another reason why it is important for Australian governments to observe the calls from IISI and OECD to eliminate subsidies and artificial government support for new steel making capacity.

I believe, based on economic modelling BHP Steel has commissioned, that if a new steel project – say at Newcastle – achieved long-term success in an area which competes with BHP Steel, then every new job created in Newcastle would be offset by a job loss in the Illawarra region – a pure job transfer.

THE COMPETITIVENESS OF AUSTRALIAN STEEL - COST, EFFICIENCY AND TECHNOLOGY ADVANTAGES

Prior to and since our public listing, BHP Steel has talked to the major investment markets and visited analysts, institutions and other potential investors.

The perception amongst some, particularly in the United States, was that steel is an industry in decline. "Why would I invest in a steel company?" was the question BHP Steel was often asked.

Our answer was, despite what you might think about the steel industry, BHP Steel is a different type of steel company.

The factors that differentiate BHP Steel include our range of market leading, value-added branded products, low position on the cost curve, consistently strong cash flows, geographic and product diversity, and growth opportunities in Asia.

Our low cost position – BHP Steel is in the lowest decile of the world steel production cost curve – is the result of proximity to competitively priced natural resources, such as coal and iron ore, access to efficient transport links – particularly deep water ports - and massive investment over many decades in plant, technology and people.

BHP Steel's success can also be attributed to the attractiveness of our branded steel products in the Australian and New Zealand markets.

Branded products play a major part in differentiating BHP Steel from the majority of steel producers worldwide, where branded products are rarer and producers tend to take a commodity approach to their business.

BUILDING CUSTOMER RELATIONSHIPS

I believe the next phase in building the competitive advantage of Australia's steel industry lies in the area of customer service, and in improved integration with customers.

Although advances in technology and continuing progress in tightening up our cost structures are essential, advances in these areas are continuous and they do not represent as great an opportunity for break-through as does transforming our companies to be truly customer focused.

Past negatives of our industry include:

- Delivery performance well below world's best practice;
- Strike-prone behaviour from production workforces who have seen themselves as totally removed from the customer interface – this has repeatedly inconvenienced customers; and
- Treating major export customers as secondary to the needs of domestic customers.

BHP Steel has been through a tumultuous period in industrial relations in the last 18 months as we have wrested back the right to manage our organisation without needing to seek the permission of local union leaders.

Our relationship now is a more appropriate one based around consultation and engagement, but not permission-seeking.

Educating our workforce about the importance of satisfied customers to their job security has also been important.

In relation to our major customers, we have worked hard to strengthen and deepen our relationships.

For my business – BHP Steel's Industrial Markets – this has included working extensively with our major domestic customers OneSteel and Smorgon Steel.

Over the past couple of years BHP Steel has placed great focus on deepening the quality of the relationship we have with major overseas customers.

In the international market, I’d like to dwell for just a moment on two of our major customers.

Last week I was in Korea to celebrate the delivery of the two millionth tonne of steel to one of our largest customers, the Dongkuk Steel Mill Company Limited.

Since the relationship between BHP Steel and Dongkuk began in 1978, it has blossomed to the extent that BHP Steel is now a significant part of the ‘front end’ for Dongkuk’s operations.

Next month we will celebrate the sale of our one-millionth tonne of steel to one of our major US customers, Steelscape, which was formerly owned by BHP Steel but now operates independently.

Like Dongkuk, Steelscape has structured its operations to rely on BHP Steel for essential feedstock.

In fact, the majority of BHP Steel’s customers in the US are based on the West Coast and don’t have any primary steelmaking facilities.

They face a choice of either buying feedstock from the inefficient large integrated producers on the East Coast of the US, or buying from overseas – especially ourselves and the Brazilians.

And BHP Steel can ship slab and hot rolled coil from Australia or New Zealand much cheaper than they can rail it from the mid-West.

In exempting Australian exports of slab and hot rolled coil from tariffs, the US Administration recognised the vital role the Australian steel industry plays in its own domestic steel industry.

Our other major US customer is California Steel Industries, to whom we have been selling slab for many years.

It’s these long-term relationships, both domestically and internationally, that help build the foundations for our success. As these customers grow their sales, we will grow with them

Through investment in relationships, in marketing, and in our brands, we are able to cushion ourselves from the vagaries of the global steel industry.

Although we sell a lot of steel internationally, our approach is that we are not selling a commodity; we are selling a differentiated product, backed by our excellent brand and reputation, by technical assistance, and by after-sales service.

BHP Steel is not out there selling on the spot market to the United States, nor are we contributing to the related problem of wildly fluctuating prices.

We are acting in a disciplined manner, selling to long-established customers.

It's a great strength for us to rely on our own sales and distribution network and not have to rely on third parties for our welfare.

Most other steel companies rely on third party traders to sell their export steel.

DEMAND FOR STEEL AND PRICING TRENDS

I'm sure all of us in this room have an interest in growing our markets.

And although I said earlier that medium-term consumption in the Australian domestic market was relatively flat, we are currently seeing strength in both the Australian and New Zealand domestic markets.

In FY 2002 we increased sales into the Australian market by some 105,000 tonnes – driven largely by continuing strength in the building market and a resurgence in demand following our earlier post-Olympics downturn.

Of course we can't rely on the building market alone. As I mentioned earlier, there are many new market opportunities BHP Steel is pursuing.

These opportunities will benefit the whole of the Australian steel industry, by stimulating demand for a range of products and services, including design, fabrication, component manufacture and installation.

Opportunities also exist for steel in major infrastructure projects, such as the expansion of the North West Shelf gas project.

All of us in this room have a shared interest in seeing an increase in underlying demand for steel products.

The level of global steel demand is strongly driven by the level of economic activity and industrial production around the world.

Industrial production and GDP are key indicators of the health of end-use industries, and therefore for the steel industry itself.

In terms of the outlook going forward, IISI statistics indicate that world apparent consumption of finished steel products is projected to rise at an average annual pace of 2.2% or 50mt over the 3-year period 2001-2003.

In 2002, a 12mt or 7% increase in China steel demand accounted for three quarters of the increase, as the Rest of the World is projected to increase by only 3.7mt or by 0.6%.

Outside China, consumption is flat.

One would hope that the prospect of a world economic recovery should positively impact steel consumption for 2003.

During the past six months, following the s.201 decision, the global steel market has seen a surge in prices across the board.

World slab and HRC prices have averaged increases of between 30%-40%, compared with the unbearably low levels registered in the first quarter of this calendar year.

Improving markets in some parts of the global economy, particularly in Asia, have also aided the upward movement in prices as steel demand levels slowly recover.

While I am heartened by current levels of HRC pricing – an unintended consequence of President Bush’s tariff decision, just because we’ve had a temporary lift in prices on the back of US protectionism, doesn’t mean we should all relax.

In fact, we are already seeing a return to production of in excess of 7 million tonnes of steelmaking capacity over the last quarter of this year.

Looking ahead, unless real demand for finished steel products picks up markedly and there is real disciple around the supply side, there remains a downside risk to the upward trend in prices globally – especially given continuing overcapacity and inefficiency in the industry.

And what cannot be denied is that the long-term price trend for globally traded hot rolled coil – an important indicator of the health of the industry - is downward.

In this environment, only the fittest will survive and prosper.

TRADE RESTRICTIONS & AN AUSTRALIA-US FREE TRADE AGREEMENT

This time last year I was in the United States lobbying the US Government not to impose tariffs on Australia steel imports.

The threat of US steel tariffs, and the aftermath of the s.201 decision, has seen me travel to the US at least once per month throughout the last year.

In March of this year, President Bush announced his tariff measures to protect the US steel industry from allegedly unfair import competition.

After some intense and I must say, outstanding lobbying by the Australian Government, and in particular the Washington Embassy, Australia was granted exemptions for 250,000 tonnes of hot rolled coil imports.

We also secured exemption from tariffs for 350,000 tonnes of slab per annum.

This allows us to continue to serve the requirements of two of our most important global customers – California Steel Industries and Steelscape.

The lobbying effort succeeded for a range of reasons including, as I said earlier, because we were able to demonstrate in Washington that Australia's steel industry had taken tough medicine over the past decade, including the closure of the Newcastle Steelworks in 1999.

We were also able to point to a vision of their future where we see our steel exports from Australia as part of the solution to the US steel industry's structural problems in the medium term.

From our viewpoint, protectionism is certainly not the answer for addressing the problems of the global steel industry.

Trade actions generally act as a negative because they sustain inefficient capacity, slow cost reduction efforts and artificially inflate steel prices.

What the current burst of protectionism has done, however, is permit steel mills to generate higher returns whilst they are protected and this can be seen in US steel prices at the moment, where the US steel-consuming industry is paying the highest prices in the world.

Going forward, BHP Steel supports the initiative to negotiate a Free Trade Agreement between Australia and the United States.

We see potential for an FTA to facilitate improved and more consistent market access for Australian steel and manufactured products into US markets.

Opponents of a free trade agreement between Australia and the United States have pointed to the 2002 US steel tariff experience as evidence of the futility of free trade agreements.

On the contrary, the steel experience clearly demonstrates the potential benefits for steel and other industry sectors of a free trade agreement.

When we look at the US situation, those countries that gained significant exemptions from tariffs – such as Canada and Mexico - were almost exclusively either developing countries, or countries that had free trade agreements with the United States.

The USA is an extremely important market for BHP Steel, yet we are still subject to a range of punitive dumping duties imposed during the mid 1990s that, for example, effectively lock us out of markets for coated and painted steels.

A free trade agreement could potentially provide opportunities for Australia's downstream value-added products, and this would include some of BHP Steel's leading brands such as COLORBOND® and ZINCALUME®.

Moreover, steel customers in the US would stand to benefit from more competitive steel pricing, compared to the historically high prices they are currently paying.

The recent passing of Trade Promotion Authority for the President by the US Congress is very encouraging.

I think we will eventually see an Australia – US free trade agreement. The only question is 'when?'

The US is the source of nearly 20 per cent of Australia's imports and accounts for around 11 per cent of Australia's exports.

Trade between the two countries totals some $8 billion plus from Australia and $15 billion plus from the United States per year.

And the United States is rapidly catching up to Japan as our biggest trading partner.

Ultimately, as with the s.201 tariffs, the timing of an Australia-US free trade agreement will be determined by domestic politics in the US.

But the Australian steel industry will be well positioned to prosper, once that agreement is signed.

CONCLUSION

Today's Australian steel industry is well regarded. It's seen as an industry that is built on solid foundations.

And it's an industry that has 'done the hard yards' in reducing overcapacity and introducing some market discipline.

The Australian steel industry has some tremendous advantages.

We are a low cost producer by world standards.

We have ready access to vast reserves of coking coal, iron ore and other minerals.

We have efficient transport links and infrastructure.

And we have an industry that has been built up by investment in plant, technology and people, over many decades.

We've taken steps to reduce overcapacity and ensure we have the foundations for long-term profitability.

And we've been disciplined in the way we market our product.

We have demanding and sophisticated customers here in our domestic markets. This factor has shaped our market offers, which are as good as anywhere in the world.

Australia's steel industry has many, many strengths. And, I believe, it's an industry that is poised for an exciting and prosperous future.

Ladies and gentlemen, thank you for your time this morning

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